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No. 89-1859

Supreme Court, U.S.
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IN THE
Supreme Court of the United States
October Term, 1990

ALBERT J. DeANGELIS,

Petitioner,

vs.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY BRIEF

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PRELIMINARY STATEMENT

This brief is respectfully submitted on behalf of ALBERT DeANGELIS (DeANGELIS) in reply to the brief submitted by the Securities and Exchange Commission in opposition to the petition for a writ of certiorari. A Panel of the United States Court of Appeals for the Second Circuit summarily affirmed a

judgment entered against DeANGELIS by the United States District Court, Southern District of New York. The District Court's opinion consisted of its adoption, without change, of the proposed findings of fact and conclusions of law submitted by the Securities and Exchange Commission (the SEC).

The District Court (Hon. Kimba Wood) concluded that DeANGELIS was liable for violation of Section 10(b) and Section 14(e) of the Securities and Exchange Act, 15 U.S.C. 78(j)(b), 78 (n) (e), Rule 10b-5, 17 C.F.R. 240.10b-5, Rule 14e-3, 17 C.F.R. 240.14e-3 for trading in securities. Petitioner does not here challenge the findings of fact made by the District Court. Rather, petitioner respectfully contends that the facts as found by the District Court were insufficient to support the Court's finding of liability and that the lower Courts interpretation of the federal securities laws concerning "insider trading" expands the reach of the law well beyond its statutory basis.

REASONS FOR GRANTING THE PETITION.

I. THE PETITION SHOULD BE GRANTED BECAUSE THIS CASE PRESENTS IMPORTANT ISSUES FOR THIS COURT'S REVIEW CONCERNING THE APPLICATION OF THE CIVIL ENFORCEMENT PROVISIONS OF THE FEDERAL SECURITIES LAWS, THE ORDER OF THE SECOND CIRCUIT CANNOT BE RECONCILED WITH RECENT DECISIONS BY THAT COURT OR WITH ESTABLISHED PRINCIPLES OF LAW APPLICABLE TO SUCH CASES.

It is respectfully submitted that the petition should be granted because of the important issues presented as to the application of the enforcement provisions of the federal

securities laws. See *SEC v. National Securities, Inc., et al.*, 393 U.S. 453 (1969) (Petition for Certiorari granted because of importance of questions raised to administration of securities laws); *Dirks v. SEC*, 463 U.S. 646 (1983) (Petition for Certiorari granted in view of the importance to the SEC and to the securities industry of the questions presented). Further, it is submitted that the petition should be granted because the order in the DeANGELIS case by the Second Circuit cannot be reconciled with subsequent decisions by that same Court in *United States v. Robert Chestman*, 903 F.2d 75 (2d Cir. 1990), petition for rehearing in banc granted, August 24, 1990 and *Securities and Exchange Commission v. Unifund SAL and Tamanaco, Saudi and Gulf Investment Group, et al.* (slp. opn. 2d Cir., decided August 3, 1990), with respect to the issue of the burden placed on the SEC to establish a tippee's violation of the securities laws. The issues presented in this case are the same as those before the Second Circuit en banc in the *Chestman* case. However, only this Court's pronouncement on the important issue of the scope of the federal securities laws can assure uniformity in all of the Circuits.

While it is conceded that a conflict between two opinions in the same circuit on the same issue of law does not in and of itself justify this Court's review, it is submitted that the pre-eminent historical role of the Second Circuit in shaping the development of jurisprudence concerning the federal securities laws makes it most appropriate that the issues presented here be reviewed by this Court. The present petition provides this Court with the vehicle to review the scope of the enforcement provisions of the federal securities laws. Because of the broad criminal and civil sanctions which are implicated upon violation of these federal laws, it is submitted that uniform rules defining the standards of liability of persons trading in securities are essential.

The opinion of the District Court as upheld by the

summary order of the Second Circuit, imposes liability against DeANGELIS under the anti-fraud provisions of Rule 10-b(5) of the Securities and Exchange Act without proof of his scienter or knowledge on DeANGELIS' part that he was trading on misappropriated non-public information obtained by a twice removed tipper in breach of a fiduciary duty to his employer. In addition, the Court's opinions impose liability against DeANGELIS, under Rule 14(e) of the Securities and Exchange Act for trading in options without any showing that he knew or should have known that he was in possession of material, non-public information about pending tender offers imparted by the "offering person" or someone acting on his behalf.

The lower Courts expansive interpretation of the reach of the law to make a subsequent tippee liable where it was shown that he had no connection whatsoever with the primary tippee or of the primary tipper, did not know and did he have the ability to find out the source of the information, where the source was employed or the nature of the source's occupation or that the information was obtained via a violation of fiduciary duty to an employer, threatens the viability of the market by imposing an extraordinary and burdensome investigative duty upon persons wishing to trade in stocks or call options. In this case, DeANGELIS relied upon the speculative successes and the recommendations of his friend Musella and upon his own evaluation of public reports in reaching a decision to make security purchases in the three companies, Marathon, Penn Central and Signode. The record is devoid of any showing that DeANGELIS knew that the information was appropriated, non-public information obtained in breach of a fiduciary duty. Further, with respect to the call options in Marathon and Penn Central, DeANGELIS neither knew or had the ability to find out that the information was material, non-public information imparted by a proposed tender offeror or its agent.

In the case *sub judice* , DeANGELIS, not an insider and

owing no fiduciary duty to the corporations involved, was effectively held liable under the provisions of Section 10(b) and Rule 10b-5 because the District Court found he possessed non-public market information. In addition, the District Court premised liability under Section 14e-3 and Rule 14e-3 upon its conjecture that DeANGELIS had reason to know that tips concerning Marathon Oil and Penn Central call options were derived from the proposed tender offerer or its agent. Yet, the record shows with clarity that the tender offeror or its agent were entities and individuals whom DeANGELIS did not know, know of or have any connection with whatsoever. Premising liability upon a tippee equal to or as broad as that of the tipper is inconsistent with the provisions of the federal securities laws.

In *United States v. Chestman*, 903 F.2d 75 (2d Cir. 1990), petition for rehearing in banc granted August 24, 1990, the Court of Appeals, relying upon this Court decision in *Dirks v. S.E.C.*, 463 U.S. 646, 660 (1983), noted that for a tippee to be held liable under Section 10(b) and Rule 10b-5, three elements must be established. The first element is that the tipper held a fiduciary duty to the party from whom he obtained the information. The second element is that the tipper violated his fiduciary duty by appropriating material non-public information. The third element is that the tippee has knowledge of this breach of fiduciary duty by the tipper. In *Chestman,* a Second Circuit panel, comprised of Judges other than those summarily affirming the judgment against DeANGELIS, found that liability on this ground could not be sustained because:

> "The government can point to nothing in the record demonstrating actual or constructive knowledge on the part of Chestman that Keith Loeb was pledged to secrecy by Susan Loeb, who was pledged to secrecy by Shirley Witkin, who was pledged to secrecy by Ira Waldbaum.. Loeb testified that on direct examination that he could not recall describing the information as confidential, and there is no

evidence that he ever alluded to the source of the information. *** It is impossible to attribute knowledge of confidentiality to Chestman in view of the attenuated passage of the information and the absence of any showing that the information retained any kind of confidentiality in the hands of Keith Loeb."-Id. at 77.

Although the SEC in the present case could point to nothing in the record showing that DeANGELIS knew or should have known that Ihne owed a fiduciary duty to the law firm of Sullivan and Cromwell where he was employed and that he breached his fiduciary duty by misappropriating material non-public information, the Second Circuit summarily affirmed a finding of liability under Section 10(b) and Rule 10 (b) (5). As the record is undisputed that DeANGELIS neither knew, knew of or had the ability to find out the source upon which his friend Musella based his recommendations, it cannot be found that DeANGELIS knew that he was trading on material non-public information obtained from a twice removed tipper in breach of fiduciary duty. Indeed, the District Court did not find that DeANGELIS had actual or constructive knowledge of the source of the recommendations or that they involved a misappropriation in breach of the tipper's fiduciary duty to his employer. Rather, the District Court speculated that DeANGELIS should have known that the recommendations were obtained from such a source.

In *Securities and Exchange Commission v. Unifund Sal et al.*, (Slp. Opn., 2d Cir. August 3, 1990), yet another panel of the Court rejected such a speculative conclusion as the basis to uphold a broad based preliminary injunction against future violations based upon Section 10(b) and Rule 10(b) (5). The Court observed:

"An insider trading violation requires proof not only that the defendant traded on the basis of material nonpublic

> information but also that in doing so he knew or should have known that he was breaching a fiduciary duty.
>
> In this case, the Commission has not identified the person or entity alleged to have conveyed inside information to either appellant. It is therefore more difficult than in the typical tipping case to determine whether, even if appellants obtained inside information, they traded upon it in breach of a fiduciary duty that they knew or should have known existed. Though a tippee's duty to disclose or abstain is derivative from that of the insider's duty, we do not know from whom such a duty might derive in this case.

The Commission attempts to bridge this fundamental gap in its evidence with speculation. Even if we assume that it has sufficiently shown an adequate probability that Candid Peyer, Espirito Santo's broker at Raymond Jones, had material nonpublic information from an insider, we are then asked to infer the requisite relationship to Unifund and Tamanaco from wholly inadequate circumstances. ***The link to Unifund assumes that Peyer's information was conveyed to Raymond Jones, then to Bank Audi, then to Unifund, under circumstances where Unifund knew or should have known of a nondisclosure obligation. These assumptions are unsupported on this record." Slp. Opn. at 5893, 5894, citations omitted, footnote omitted).

It is submitted that in light of the panel opinions of the Second Circuit in *Chestman* and *Unifund*, re-affirming the requirement that the Government prove that the tippee obtained material non-pubic information from a tipper who violated his fiduciary duty, under circumstances where the tippee knew or should have known of the source and nature of the information, the summary order of the Second Circuit in the DeANGELIS case can only reasonably be viewed as an erroneous decision of the District Court which, as a result of its summary treatment by

the Second Circuit, was not reversed on appeal in conformity with the principles of law applicable to such "insider trading" cases.

It is submitted that this petition should be granted because this case presents issues involving the uniform application of the Securities and Exchange Act of 1934 and the Rules adopted by the Commissioner pursuant thereto and the standard of conduct of persons trading in securities. In addition, this case presents an important issue concerning the use of the Court's injunctive powers to enjoin future violations of law, where there is no indication that the legal remedies are likely to be ineffective in deterring or preventing future violations. Further, the petition should be granted here for there is a strong likelihood that the decision below will have a chilling effect on speculative market investment, which constitutes a substantial portion of the revenues received by the securities industry and provides needed impetus to the Nation's economy.

CONCLUSION

For the foregoing reasons, it is earnestly urged that the petition for a writ of certiorari to review the decision and order of the Second Circuit should be granted, along with such other and further relief awarded to petitioner as this Court may deem just and proper.

Dated: Brooklyn, New York
September 4, 1990

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